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Bank Restructuring in Nepal: Analysis of the Causes of Apparent Financial Difficulties of the Rastriya Banijya Bank

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Preliminary recommendations for loan recovery in Nepal
state-owned banks

The Environment

The financial sector in Nepal is in the process of development. The stock market has been recently activated and the Securities Board is a young regulatory authority. The banking sector has been growing. In 1984 and 1985 three joint ventures with foreign banks began operating as banks licensed by the Nepal's Rastra Bank. In 1989 all of the commercial banks have been freed to fix their own rates on loans and deposits.

At present there are seven banks operating in Nepal. It is expected by the Rastra authorities that in the near future few new joint ventures will be set up. The largest two banks are the Nepal Bank Limited (52% owned by the government) and the Rastriya Banijya Bank (100% owned by the government). The regulating authority over the entire banking sector is Nepal Rastra Bank which is placed, in the supervisory organisational structure, below the Minister of Finance. The main sector regulatory departments are Banking Operations Department (responsible for banking regulation) and Bank Supervision Department (responsible for bank examination).

Problem Areas

Extensive interviews with the government officials responsible for the financial sector and representatives of the banking community and the analysis of the somewhat outdated reports prepared by the US firm of Booze Allen testify to the difficult situation of the Rastriya Banijya Bank in particular and the banking sector control in general. The problem areas are listed below.

1. **Non-equal regulatory treatment by the government regulatory authorities of government-controlled banks vs. privately-held banks.** An especially drastic example of unequal treatment of the two sectors is the possible exposure of the employees of a **state-owned** bank to criminal liability for writing-off loans, even if such loans have been classified by the bank officials as non-performing assets. **Liability** for the so called “misappropriation of government funds” does not arise automatically, but a mere danger of such liability justifies bank’s employees reluctance to write off bad loans and thus more accurately reflect true value of the bank’s assets. It remains uncertain to what extent the threat of such liability is **real** (Nepal Bank Limited did engage in writing-off activity despite the threat), however its threat may serve bank employees as an excuse to avoid engaging in a serious loan **recovery** effort.

Other examples of unequal treatment of the public and private banking sectors is the requirement that the state banks accept **all** deposits regardless of their size. This requirement results in an increased **transaction** costs for the state banks and prevents them from appropriately structuring **their** balance sheets. Together with the requirement that for every city branch state banks have to open five rural branches the state banks are placed at a competitive disadvantage **vis-a-vis** private banks. The General Manager of RBB stated that **where** he obliged to operate on a truly commercial basis he would reduce the number of branches to 50 (out of 149 presently maintained).

2. **Overlapping of ownership and regulatory functions of the government.** In the case of the **state-owned (controlled)** banks like Nepal Bank **Limited** or **Rastriya Banijya Bank** overlapping of the two functions of the government poses a serious problem and threat to a successful resolution of their method of functioning. This is **especially** important in the case of the RBB where the government-regulator is powerless to control and supervise the bank run by the government-owner. It is very important that the issues relating to the internal procedures, **organisation** and functioning of the state banks should be resolved by the government acting • as the owner • through the board of directors. In addition **state-owned** banks are used by the government as a transmission belt for the implementation of government economic policies (e.g. its policy with respect to providing access to banking services for the rural communities). Banking activities relating to the implementation of the economic programs are not separated **organisationally**, or in the accounting sense, from the normal commercial activities of the of the RBB. This makes it **especially difficult** for the supervisory authorities to distinguish in certain instances the profitable and loss-making operations. [According to the management of the Nepal Bank Ltd. 50%

of the branches lose money. 50% of the bad loans are in the government priority area. and 12% of loans have to be extended to the agricultural sector)

3. **Weak legal/court system** preventing the banks from effectively recovering the loans by means of court proceedings and, in general, relying on the strength of law when extending credit. **Conservatively** operating private banks in Nepal engage in “name lending” and in the case of borrower’s non-compliance with the terms of credit agreement rely on the threat of social pressure to recover the money. Lack of even a **partially** efficient system of legal loan **recovery** and lack of **uniformity** in the application of the law **make the** emergence of sound banking impossible. Additionally, lack of **bankruptcy** law enabling banks and other creditors to recover part of the money invested in small businesses **will** hamper not **only** the growth of larger investment credits in the bank’s portfolios but also the growth of the small business sector.
4. **Occurrence of local problems** related to the fear of bank branch employees to auction-off non-paying debtor’s property and local political pressure in support of some non-paying borrowers.

Regulatory Problems

1. **Internationally incompatible bank regulatory framework, preventing the international recognition of the Nepalese banks as financially sound and reliable.** The most important area where the **incompatibility** must be removed is the area of prudential regulations.
2. **Lack of standardised and clearly understood by the banks loan classification requirements.** The lack of regulations complying strictly with the **BIS** standards forces some, more conservative private banks, to introduce internal regulations that are more stringent than those imposed by the **Rastra** Bank. Lack of rigidly set standards for loan **classification** allows state owned banks, and possibly some private banks, to use a fair degree of discretion in classifying the loans. This in turn leads to a **significant** distortion **in** the reported **balance** sheets of the banks
3. **Lack of regulations limiting discretionary, “family” and “friendship” loans extended by banks’ employees.** This is a **significant** problem in the state banks. In the past this led to a rapid growth of politically motivated credit extension. Presently, the **lack** of information on the ties of past **and present** borrowers with the bank and lack of any regulation dealing with the bank’s credit policy with respect to borrowers related to

the bank exacerbates the problem. The problem of "family" and "friendship" loans will continue, however, even if reporting is put in place, so long as the banks lack clear internal procedures for credit extension. The minimal requirements in this area should be imposed by the regulators, but the burden of ensuring sound credit extension practices lies with the owners.

4. **No guidelines for disclosure requirements.** Lack of **regulatory** requirements for transparent balance sheet disclosures. Data available to the Rastra Bank appears to be very scarce and inconsistent with independent consultant's analysis of the state bank's financial situation. In general, it does not seem that the regulatory authority can assess **adequately** the **true** state of the banking sector, in particular that of the state-owned banks.
5. **Not sufficiently frequent report gathering from the banks** (reports on loan classification are required only once a **year**). Some private banks did not have an on-site inspection of the **Rastra** Bank for a number of years. Infrequent on-site inspections and a professionally weak supervision **staff will** not be capable to monitor and control the operations of the banking sector. Reporting on the quality of the loan portfolio (asset quality reporting) is required only once a year (should be done quarterly).
6. **Lack of thorough and reliable audits of the banks** (bank floatation and related disclosure requirements may somewhat remedy this problem but certain regulatory audits should be broader in scope and have different emphasis than the annual reports published by the publicly floated banks).
7. **The requirement of overdue interest accrual and the subsequent provisioning for the capitalised loans results in a rapid growth of the required provisions.** **Capitalisation** (or accrual) requirement means that added interest must pass through the Profit and Loss account registering "apparent" profit. It also creates a situation where banks must create provisions (in the case of state bank, to cover accrued interest on the **loans** which it cannot write **off**) even if no new loans were reclassified. This approach does not seem to be economically **justified**, as provisions are to cover "**loan** losses" and not all of the unrecovered interest accrued or capitalised on the loans which are and most probably never will be performing. In many instances even the principal of the loans (or a large part thereof), as it will happen in the case of many agricultural loans, **will** never be **paid-off**. This means that the value of the loan is negligible and thus continued **accrual** or **capitalisation** of interest distorts the actual **size** of the low quality loans possibly leading to overstating the new capital requirements.

Relevant bank organisation/functioning problems (RBB)

1. **Weak exercise of ownership controls by the government.** It appears that the shareholder (the government) did not endow the Board of Directors with sufficient powers **and** responsibilities to **effectively** control and supervise the activities of the bank management, or that the Board lacks **the** will to efficiently control and direct the banks. The weak exercise of control is the result of the dilution of power of the government and responsibility of bank officials to the government.
There appears to be a lack of strong **policy** centre within the government to direct the state-owned banks. The governance of the banks, operating as corporations, should be based on the exercise of ownership privileges **by** the controlling owner. It is the controlling shareholder who has a decisive voice in the selection of the board members who in turn are accountable to that shareholder. In the case of RBB, the board is made up of the high-ranking **officials** from various **Ministries** accountable for their performance to the abstract "**government**". It seems that they should be accountable before one higher ranking government **official** who in turn will be responsible before the Parliament for the operations of the RBB (and all other state banks);
2. **Lack of clear strategy and the time-frame for the bank privatisation or partial floatation** and thus, lack of clear management **strategy** and goals to be implemented by the Board. It is unclear whether the proposed restructuring and **recapitalisation** are to be implemented as a step in the preparation of **RBB** for privatisation or as an end in themselves. Although debt restructuring is necessary in either case, the need for a recapitalisation of a fully insured government bank that is unlikely to ever be allowed to fail is less justified. Presently, the need to restructure and **recapitalise** is perceived, but with no clear view of how to remove the causes of the present state of the **RBB** loan portfolio. In view of the weak government control over the RBB the government should consider at least a partial **sale** of **bank's** shares to introduce management participation of private shareholder (as in the case of **NBL**) and thus put in place new controls over the credit extension practices and assets quality.
3. **Lack of periodic independent review of bank's financial standing**, necessary for the shareholder's assessment of bank's performance. Such review should be conducted independently of the regulatory-type reviews and should be contracted for by the meeting of the shareholders or in the case of RBB the owner. The interest of the regulatory authority in ensuring the **safety** of the banking sector in its entirety and a

large bank like **RBB** in particular differs from the interest of the owner (here the government) to ensure the soundness and **profitability** of its corporation operated presumably for commercial **purposes**. Thus the board-representative of the owner-should conduct periodic independent and thorough reviews of the bank's accounts for the purpose of the proper exercise of their **supervisory** and managerial **authority**. With insufficient **regulatory** control over the bank and with no independent review of the bank's portfolio (independent of the bank management influences) the owner will be incapable of properly **identifying** problem areas and undertaking steps to remedy a potentially dangerous situation.

4. **Lack of loan recovery strategy and time-frame and of effective internal procedures for the conduct of the recovery program.** In general RBB lacks any strategy for loan recovery and NBL has a general strategy of loan **recovery** but with no clear framework for its implementation. No significant **organisational** changes have been introduced in RBB to provide incentives for the bank employees to conduct vigorous (or indeed any) work to improve the quality of bank's assets. The RBB management does not appear to be sensitive to the problem of low quality of the bank's assets. It defends its lack of involvement in any recovery program by pointing to the danger of criminal liability in the case of loan forgiveness (at least partially justified argument but did not prevent NBL from achieving some success in this area). At the same time it either ignorantly or through **wilful** misrepresentation maintains that for the last three years no loans were reclassified as 4th, 5th or 6th category according to the classification used by **the Rastra Bank**. It does not appear that the management is aware of the true capital needs of the RBB, yet it is very eager to be **recapitalised** by the government.
5. **Insufficient central consolidation of the information about and control over the loans granted.** The information about the loans granted is dispersed throughout the branch network making it particularly **difficult** and **costly** for an independent auditor to assess the true state of the loan **portfolio**. It is **doubtful** that this situation may be remedied through increased "paper reporting" to the head office.
6. **Lack of clear and strict loan extension procedures.** Theoretically every **loan application** must be approved by at least one loan committee, but in practice the participation of such committees is **often** just **a formality**. A high ranking bank official **may persuade the** committees to extend a particular loan without **justifying** such an extension by introduction of proper supporting documentation. There is no uniformity in placing the responsibility for the loan extension with any particular individual or

group of **individuals** and neither the owner nor the regulator will be able to counteract bad practices by **penalising** the **guilty** parties.

***The** responsibility for implementing changes in the areas referred to in pts. 4, 5 and 6 should be placed with the Board (which in **turn** should delegate the duty to prepare time-framed implementation programs to the management of the bank). The Board, or a selected group of Board members, should periodically examine and continuously supervise the implementation of such changes. As the changes relate to the internal **functioning** of the bank, they should be of no direct concern to the regulatory authorities.

Proposed actions to be undertaken (relating **primarily** to RBB)

It is not **necessary** in the case of the financial restructuring of one bank to introduce a special law obliging the bank to restructure **itself**, as was done in Poland. In the long-term, however, legal changes should be made, introducing conciliation and bankruptcy proceedings and enabling **future** debtors and creditors to restructure bad loans.

Short term

1. It is the statutory responsibility of the Board of Directors to ensure that the existing problems relating to **the RBB's** internal organisation are corrected. Members of the Board are also responsible before the shareholder (the **government**) for the performance of the bank. The **Board** of directors, in turn, delegates parts of its rights and **performance** of its duties to the executive management of the bank. In the case of internal restructuring of the bank for the purposes of dealing with a **severe** bad debt problem the Board should set up a special committee (made up of its members, hereafter called Board Committee) responsible for **day-**today supervision and implementation of the loan **recovery** program (Program). The Program itself should be prepared by the bank management with the **involvement** of the Board Committee members. The Polish experience shows that the following **organisational** changes should be made within banks **facing** a bad debt problem of the magnitude occurring in RBB:

- create a **specialised** loan-recovery, or work-out department in the bank's central **office**. Ideally, individual members of the Board of Directors should be assigned to **supervise** divisions of the **bank** which are made up of groups of departments. The loan

recovery department should be created and located in a division that is **different** from the division where the credit department is located. Also, different members of the Board should be responsible for the supervision of the two divisions. The head of the WOD should be hired from the outside of the bank to ensure that he/she is in **every** way detached from the previous credit extension process. The initiative for arranging the internal structure of the WOD should be **left** with the newly hired head. It must be expected that such person and the WOD itself will be viewed with hostility as “imposed on the bank” and as competing with the credit department and its branch officers for the credits “that may be performing at some point in the **future**”(this has been the experience in the Polish banks). Any disputes arising in the **future** between the two departments (related e.g. to the transfer of loans from the credit department to the bad debt department, or related to the allocation of profits and expenses between the two departments, etc.) should be settled at the level of the Board.

- i) The work-out department (**WOD**) should be responsible for direct and indirect supervision of the debt restructuring processes.
- ii) The internal organisational scheme of the WOD should divide the responsibility for the restructuring of the non performing loans between the branches and the WOD in the central office by setting, for example, specific monetary amounts of loans which **qualify** such loans for restructuring by the branch employees and the WOD respectively. In the case of the loans, the restructuring of which is the responsibility of the branches, WOD exercises an indirect control over work-out unit created in each branch (control of whether the loan has been restructured, written-off, etc. within a prescribed period of time from the moment of its reclassification).
- iii) For the loans the restructuring of which is the responsibility of the WOD, the branch units should be responsible for the collection of the necessary loan documentation, preliminary negotiations with the non-paying debtor and the submission of ~~all the~~ ^{of} materials to the WOD, with their **recommendation** as to the future action, within a prescribed period of time from the moment of reclassification of the loan
- iv) **Upon** the receipt of the loan documents WOD should **perform**, within a prescribed period of time, a thorough analysis of such documents and formulate its opinion as to the steps that should be undertaken with respect to the debtor.
- v) **WOD's** analysis and its **recommendations** should be submitted to the credit committee, responsible in the bank for large credit decisions. For the loans of the

amount exceeding a specific amount set by the Board, the credit committee should **forward** the loans, with its **attached opinion**, to the Board responsible for the **final** decision. The loan amount settings serving as the basis for the division of responsibilities between **various** units of the bank may be adopted from the experience of the Nepal Bank Ltd. which additionally introduced regional **work-out** committees approving the restructuring of loans amounting up to 1 ml Rs.

- vi) Depending on the size of the loan the restructuring should be implemented either by the **specialised** branch units (for smaller loans) or WOD employees (for larger loans).

The proposed internal **organisational** structure and general procedures should be augmented by special procedures introduced for the purpose of dealing with a specific loan **portfolio** determined by the independent auditor refer to below (as of a certain date e.g. December 31, 1993). Before such independent audit can be completed the procedures should be set in place and work-out activities should be undertaken with respect to the loans presently **classified** as 5th and 6th **category** according to the Rastra Bank classification.

- **introduce internal procedures for monthly classification of the loans by the credit department.** In view of the lack of strict and **unambivalent** loan classification used by the Rastra Bank the Board of Directors should **introduce** and enforce internationally **recognised** rules in this area (**four-category** classification). These should be binding on the bank as internal regulations until the **supervisory** authority (Rastra Bank) introduces them as regulations applying to all Nepalese banks. Credit department of the RBB **should** be made responsible for a monthly update of the quality of the loan **portfolio** and expected to **reclassify** the non **performing** loans into "**doubtful**" or "loss" categories. Any usage of "subjective" elements in the reclassification process should be disallowed for the purpose of restructuring and reclassification should be based solely on the time factor (time of delay in the repayment of the principal and interest). Such **streamlining** of the process would ensure transparency and clarity of its implementation and shield it from the bias of credit **officers** at the same time making it easy to assign responsibility for **failure** to **reclassify** the loans.
- **introduce procedures for immediate and automatic transfer of the loans classified as 3rd and 4th category by BIS standards (4th, 5th and 6th category by presently used standards if the Board decides against adopting a new standard) from the credit department to the recovery department following every monthly reclassification.** For the loans with documentation located at the head office such automatic **transfer**

should take place between the credit department and the WOD. In the branch **offices** reclassified 3rd and 4th category loans should be transferred from the credit unit to the **loan recovery** unit. Reliance on automatic transfer of the loans will limit the likelihood of occurrence of disputes between the credit and WOD **officers** and streamline the entire process. Bank **officials** must be **especially** careful to design the loan reclassification standards and the transfer procedures in such a way that it is impossible for **the** credit department to “hide” and withhold the non-performing loans from their transfer to WOD (and **respectively** at the branch level), thus avoiding incurring a loss (it is the Polish experience that whenever the discussed below internal accounting procedures are introduced, the credit department will attempt to prevent loan transfers).

- **introduce a limited number of restructuring paths and enforce timely and efficient implementation of the recovery/restructuring process.** The management should be responsible for devising various restructuring methods applicable to the peculiarities of the **RBB's** loan portfolio (some experience of Nepal Bank Ltd. on the methods used and their effectiveness can be transferred). For example, Polish-type conciliation proceeding seems of little use in the environment where majority of loans are extended to family **farms** etc. (instead of large industrial enterprises with many hundreds of corporate creditors). Partial write-off and rescheduling, presently used, seems as a very good idea. Perhaps a regulatory or statute-based waiver of bank secrecy with respect to non performing loans for public sale could also be **useful**. With respect to small businesses a secondary debt market could develop and with respect to **private/family** loans the **threat** of public sale offer of one's loan, in a small local community, could work to secure repayment of the entire or restructured **loan**.

Oligopolistic position of the two banks in the rural areas may also allow them to condition maintenance of deposit accounts in either RBB or NBL on the repayment of the past due debt (the banks could exchange information on the local individual bad debtors).

- **provide built-in performance incentives in all units responsible for the loan recovery.** The basis for introducing any such incentive scheme is the creation of separate internal accounting in the WOD, credit department and branch recovery units and branch credit units. All of these should be turned into some type of profit and cost centres capable of incurring losses and generating profits as the result of their lending and recovery operations. The solution proposed to the Polish banks was to create such centres in the head **office** based on the divisions (division where regular credit department is located and the division where WOD is located). Of course, the most **difficult** problem would be to **allocate** between such centres the indirect expenses **and** recoveries. The direct expenses would be incurred whenever any loss is **recognised** by either

department/division. In the case of the credit **department** such **loss** is **recognised** at the moment the department transfers a loan to a higher category and creates a provision. The loss incurred is equal to the provision created.

Upon the transfer of 3rd and 4th (**4th, 5th and 6th**) category loans from the **credit** department to the **WOD**, **WOD** would incur expense equal to the nominal **value** of the loan transferred minus the value of the provision created by the credit department. Thereafter **WOD** would carry the loan on its accounts at the value it was “purchased” for from the credit department. **WOD's** profit would be equal to the difference between the value recovered and the “**cost**” of the loan. Credit departments profit would be generated by the interest margin between the loans it extends and the internal interest charged by the bank’s own treasury. A parallel mechanism could be introduced at the branch level.

- **prepare sound, transparent and highly formalised procedures for loan extension and loan forgiveness.** Bank management should be responsible for the preparation of a **formalised** scheme of credit extension, whereby the responsibility for extending various levels of credit is clearly assigned and rigid and transparent procedures reduce the probability of corruption. In my opinion loan officers at the branch and head office levels should be prohibited from extending additional loans to any existing borrowers, whose debt has been classified as **4th, 5th or 6th** category. Clear standards should be set for making extension of credit depend on **borrower's financial** situation and past record, instead of the unsupported opinion of the branch manager or bank’s president. Depending on the value of the **loan**, branch management, head office credit committee, bank management and the Board of Directors should be made responsible for making decisions on the extension of the new credit.

*Government **officials** sitting on the Board of Directors should avoid engaging too deeply in the **internal reorganisation** of the bank, but should exercise government’s ownership **function** through thorough and frequent supervision. The Board of Directors should be responsible to the Minister of Finance for the implementation of the changes.

2. **The removal of criminal liability threat for writing off loans.** The process of **writing** off loans should be **formalised** in order to avoid the appearance of impropriety. The bank should maintain files containing the loan agreements and loan forgiveness forms (with **clearly** marked names of people representing the bank and making the final decisions). All of such **files**, kept in **standardised** form, should be collected and kept in the bank’s central office for possible **inspection** by the government’s supervisory authority. The credit department should be responsible for the supervision of credit extension activities of the branch offices, and the **WOD** should be responsible for the supervision of the debt recovery units. All of

these procedures, although increasing the bureaucratic burden for the bank, will limit **banks** exposure to risk of engaging in economically unjustified transactions.

3. **A tender for the performance of a thorough and independent audit of the RBB, as of Dec. 31 1993, should be announced.** The audit should be performed for the benefit of the shareholder (the government) with the assurance that the bank officials will fully cooperate with the auditors. Potential auditor's (preferably one of the big international accounting firms) offer and presentation should reflect its familiarity with the local practices **and** realities e.g. knowledge of the capacity of the creditors to execute on the collateral & claims. It is suggested that the tender requests that the auditor includes in its audit team 4-5 members of the Nepal Rastra Bank Supervision Department, for training purposes (the auditor may also be invited to conduct training sessions for the NRB audit team employees with the hands-on experience in auditing RBB: continued reliance on this practice would lead to the growth of a group of able accountants in the NRB). Training of government auditors should be a part of **every** contracted-for audit by an int'l accounting firm. The audit should be based on the **Int'l Accounting** Standards and assess bank's capital adequacy needs based on the BIS standards.

Medium term

1. **RBB should be given a specific time period to restructure** (reschedule or partially write **off**) or write off entirely the 3rd and 4th (by Rastra Bank standards 5th and 6th and possible 4th) category loans as reported by the audit of Dec. 31 1993. At the end of this period the bank should have no loans in 3rd and 4th category classified as such as of Dec. 31 1993 (thus, the restructuring program should be **performed** on a closed set of loans) [responsibility of the Ministry of Finance acting as the owner];

2. **On the basis of the audit report the bank should be recapitalised**, but to the level not exceeding **5-6%** (in calculating the **necessary** capital adequacy ratio care should be **taken** in dealing **with** the accrued interest). The BIS standard 8% ratio is applicable to the privately held commercial banks and is used as one of the measures of soundness and **safety** of an institution. In the case of the **state-owned** bank, the ever-present readiness of the government to bail the bank out if the need arises ensures the **safety** of the bank and doesn't **necessarily call** for 8%. The 8% ratio should be achieved right before the floatation of the bank's shares to make the potential investors **comfortable** with the bank **safety** and thus increase the value of the bank. It is proposed that the bank be recapitalised with low interest government bonds to achieve the capital adequacy ratio of **5-6%**. The restructuring **program should**, however,

include a **provision** ~~that~~ upon the completion of the loan recovery process an outside audit will be performed to assess its success. For every RP recovered by the bank the government could promise to contribute a RP (in the form of recapitalisation bond) up to the level of **8-10%** capital **adequacy** ratio. This could possibly **serve** as an incentive for the bank to implement the recovery program as **efficiently** as possible.

If before or during the recapitalisation **process** it is decided that the bank requires liquidity bank **officials** may decide to **recapitalise** RBB with a long-term subordinated loan, which for the purposes of **calculating** bank's capital adequacy ratio is treated as tier **2** capital.

[responsibility of the Minister of Finance as the representative of the owner];

3. **The government should devise a procedure for separating all of its government subsidy and support programs from the commercial operations of the Rastriya Banijya Bank.** Without this separation the **recapitalisation** of the bank serves as another means of extending subsidy to chosen government programs presently engaged in by the RBB [responsibility of the government].

4. **Issuance of regulations regarding lending practices of banks** (private and state) including minimum requirements for the loan agreement forms (clearly marked names of bank officials authorising the loans) and the loan approval process. Liability for **fraudulent** lending should be introduced into the law. This should be done independently of the internal regulations of each bank [responsibility of NRB];

5. **Internal bank regulations on fraudulent lending. State-owned** banks should introduce **internal** regulations containing penalties and/or incentives aiming at limiting the amount of **fraudulent** lending. [responsibility of the government]

6. **Issuance of regulations clearly describing the loan classification methods and** requiring **all** banks to report at least quarterly to the NRB on the quality of their loan portfolio and the capital adequacy ratio of the bank. [responsibility of the NRB];

7. **Communication with a regulatory authority in a developed country** for the purpose of assessing the regulatory **needs** of the Nepal banking system and preparation of the **program** of implementation of the banking regulation reform. Such reform should be undertaken as quickly as possible to assure that a **safe** banking sector develops in an orderly **fashion**. [responsibility of the Ministry of Finance and NRB];